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SUBJECT: IMF Says Tajik Economic Outlook Rosy; Others Doubtful

Corrected copy as to comment section

Ref A: 07 Dushanbe 1753
Ref B: 08 Dushanbe 1348
Ref C: 08 Dushanbe 1470

¶1. (SBU) Summary: Despite the world financial crisis, the International Monetary Fund (IMF) has made a number of positive projections about Tajikistan's economy over the coming year, including GDP growth of 5-6%, a drop in inflation, and continued record high remittance levels. The IMF predicts the effects of the crisis will be moderated by lower food and fuel prices. The government of Tajikistan continues to argue that the isolation of its banking sector insulates it from the crisis. Dushanbe-based representatives of the World Bank and other institutions -- including the IMF's own representative here -- are not so sanguine, however, and point out a number of ways that the crisis may affect Tajikistan: through lower cotton and aluminum prices, reduced liquidity, and lower remittances. The remittance issue will be reported in more detail septel. End summary.

¶2. (U) The IMF recently completed an assessment of the macroeconomic outlook in Tajikistan as part of its Financial Sector Assessment Project (FSAP), a multi-country joint program with the World Bank to identify the strengths and vulnerabilities of a country's financial system, ascertain risks and assistance needs, and develop policy responses. The first 10-day review, led by the IMF's new mission chief for Tajikistan, Axel Schimmelpfennig, was completed in November; a final assessment based on end-of-year data will be conducted at the end of December. The reviews come in the wake of the National Bank of Tajikistan's acknowledgment earlier this year that it had consistently and purposefully misreported its balances to the IMF (Ref A). While the review is not a direct consequence of the scandal, IMF officials acknowledge that positive marks on the review will help ease the way for a resumption of IMF financial assistance to Tajikistan through its Poverty Reduction and Growth Facility (PRGF). The status of audits of key Tajik institutions connected with the misreporting scandal will be reported septel.

Despite Financial Crisis, IMF Says Outlook Rosy...

¶3. (U) During a briefing for donors in November, Schimmelpfennig provided a generally positive appraisal of Tajikistan's economic outlook, saying the IMF recently revised its growth estimate for 2008 upward to 7%, bringing it in line with the government's own projection. For 2009, the IMF estimates growth at 5-6% -- slightly lower, Schimmelpfennig said, than the 7% projection of the National Bank of Tajikistan (NBT). In a subsequent meeting, NBT Deputy Chairman Jamshed Yusupov told us -- apparently incorrectly -- that

after seeing more economic data the IMF had revised its 2009 growth projection upward to match the NBT's 7% figure.

14. (U) Schimmelpfennig said that while inflation had been high in 2008, it began leveling off in September, and the IMF was now estimating year-end inflation would come in at 16%. The projection for next year was lower, however, at 10-12%, partly as a result of lower food and fuel prices, one positive benefit from the international financial crisis. He praised the NBT for maintaining higher than expected national reserves, totaling over US \$167 million, and said the IMF was recommending that the government run a small budget surplus at year's end. Tajik authorities had been meeting all of their macroeconomic and reform targets, and if the country's performance and repayment of its IMF loans (see Ref A) continued positively, Tajikistan would be in good shape to begin considering the resumption of economic assistance, possibly as early as mid-February.

15. (U) In spite of the IMF's generally positive assessment of the economic climate here, Schimmelpfennig acknowledged that 2009 would be "tough." Although Tajikistan remained relatively insulated from the world financial crisis (ref B), the slowdown in Russia and Kazakhstan would be felt here through two channels: potential disruptions in remittance flows from Tajiks working abroad and the decline in world cotton prices. For the moment, the IMF is predicting that remittances in 2009 would match this year's record level of \$2.5 billion. A broader discussion of remittances, including serious doubts about the IMF's projections, will be reported septel. The reduction in world cotton prices was the primary factor leading the IMF to reduce its growth projection for 2009 from 7% to 5-6%. Nevertheless, the decline in prices would be

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somewhat offset by lower fuel and input prices. Although the Talco aluminum smelter is Tajikistan's largest industrial enterprise, Tajikistan was insulated from the precipitous drop in world aluminum prices because Talco's profits and losses were absorbed offshore through a tolling arrangement (see Ref C).

... But Others Disagree

16. (SBU) Others in Dushanbe's financial community, however, are not so sanguine about Tajikistan's economic prospects. Chiara Bronchi, Tajikistan Country Manager for the World Bank, said the drop in cotton prices -- from some \$1,600 a ton to around \$1,000 -- would have a significant negative effect on the country's economy. Although cotton production was responsible for a relatively small 2% of GDP, it accounted for a much larger share of Tajikistan's exports. Although she acknowledged that the world aluminum slump would not have a direct effect on Tajikistan's economy because of Talco's tolling arrangement, it would still have significant secondary effects due to slowed investment and reduced deposits in Tajik banks. Continued weak aluminum prices could also result in a renegotiation of the current tolling agreement and lower receipts. At the same time, with its balance sheet in jeopardy Talco would delay environmental, efficiency, and safety improvements at the smelter, which would affect the lives and livelihoods of many hundreds of workers.

17. (SBU) Even IMF's own Resident Representative in Dushanbe, Luc Moers, is somewhat skeptical of his organization's growth estimates. He said that the drop in cotton prices might have indirect negative effects on the banking system. Farmers who had borrowed money from commercial banks might have difficulty paying back their loans because of poor cotton sales. The banks, in turn, might ultimately have a difficult time paying back loans they received from the national budget. While ultimately the financial burden was on the banks, their failure would hurt the country as a whole. Moers emphasized that, so far, there were no signs of defaults or difficulties in the banking system, and he did not foresee any problems in the near future. If the price continued to drop, however, there could be cause for concern.

18. (SBU) Moers agreed with Bronchi that the drop in world aluminum

prices would only affect Tajikistan indirectly. These effects might nevertheless become palpable. Although Talco's financial arrangements remained deeply murky, in part because the smelters profits and inputs are managed offshore in the British Virgin Islands, Talco managers had admitted that much of the operation's profits end up back in Tajikistan through deposits in Tajik banks, particularly Orion Bank. To the extent that Talco's profits declined or disappeared, local bank holdings would also suffer. There might be "third-order" effects as well, since many of the "pet projects" of Talco managers would be put on hold. This might have a chilling effect particularly on the domestic construction sector.

¶9. (SBU) Finally, Moers said, as a result of the financial crisis the country could see some liquidity problems connected with the trade credit system. Tajik traders received loans from banks to buy products from abroad, repaying the loans after selling their stock domestically. Tajik banks that had agreements with foreign banks to cover this lending might be hit with liquidity problems as a result of difficulties abroad. To the extent that Tajik traders had difficulties selling their wares as a result of reduced domestic demand, this could lead to other banking problems. Again, Moers said that he had so far seen no evidence of such difficulties.

¶10. (SBU) Comment: While Tajikistan's banking sector is relatively undeveloped, the country is still linked to the world economy through a series of trade and lending arrangements. As these connections are explored, a consensus appears to be emerging that the financial crisis will be felt here, and that the view of some in the government and elsewhere that Tajikistan will be saved by its isolation may be unjustifiably optimistic. Bronchi and others have suggested that the IMF's rosy public projections in the face of this mounting evidence are intended to signal its solidarity with the government and encourage it to work with international financial institutions instead of around them, as it did in the recent loan misreporting scandal. Whether untenable economic projections will further this goal is open to debate. End comment.